United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-7006

UNITED STATES COURT OF APPEALS
For the Second Circuit

DAVID STIRLING, JR., and WILLIAM G. STIRLING,

Plaintiffs-Appellants,

-against-

CHEMICAL BANK, individually, and as Agent; THE CHASE MANHATTAN BANK, N.A.; MARINE MIDLAND BANK - WESTERN; MARINE MIDLAND BANK - ROCHESTER; LINCOLN FIRST BANK OF ROCHESTER (formerly LINCOLN ROCHESTER TRUST COMPANY); UNION COMMERCE BANK, FRANK BEATTY; JOHN J. IRISH; PAAVO PRIMA; "RICHARD ROE"; "MICHAEL ROE"; "MARTIN ROE"; "ALPHONSE ROE"; and "BILL ROE", (quoted names fictitious, true names being unknown, the parties intended being officers and/or employees of the respectively named defendant banks, as co-conspirators, along with other co-conspirators, not herein named),

Defendants-appellees,

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANTS-APPELLEES

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April 21, 1975

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PRELIMINARY STATEMENT

Defendant-appellee Chemical moved, on December 18, 1972, pursuant to Federal Rules of Civil Procedure Rules 12(b)(1) and (6) to dismiss the amended complaint. The other defendants-appellees joined in that motion.

On September 30, 197 , the United States District Court for the Southern District of New York (Hon. Dudley B. Bonsal), in a memorandum opinion granted the motion in all respects for failure to state a claim under Section 17(a) of the Securities Act of 1933 ("the Securities Act") (15 U.S.C. § 77q(a)), Sections 10(b), 13 and 16 of the Securities Exchange Act of 1934 ("the Exchange Act") (15 U.S.C. §§ 78j(b); 78m and 78p), and for consequent lack of jurisdiction over the pendant claims. Stirling v. Chemical, 382 F. Supp. 1146 (S.D.N.Y. 1974).

On November 8, 1974, an order of dismissal, with prejudice except for one cause of action against one defendant (Union Commerce Bank), was entered. (Appx 48a) Judgment was entered on November 11, 1974. (Appx 54a)

COUNTERSTATEMENT OF ISSUES

1. May plaintiffs, who have neither purchased nor sold securities in reliance on a false or misleading statement, assert a claim based on the antifraud provisions of the Federal securities laws?

2. Does a complaint, which does not allege that any defendant was at any time the beneficial owner of any stock in a corporation or was an officer or director of the corporation, state a claim under Sections 13(d) or 16(a) of the Exchange Act for damages for failure to file reports?

COUNTERSTATEMENT OF FACTS

The original complaint in this action was filed on October 20, 1972, naming as defendants Chemical Bank, First National State Bank of New Jersey, Frank Beattie*, John J. Irish and other alleged co-conspirators whose names were unknown to plaintiffs. That original complaint was dismissed as to the First National State Bank of New Jersey on the ground of improper venue.

Plaintiffs filed an amended complaint on December 6, 1[illegible] adding, without Court order (in contravention of Fed. R. Civ. P. 21), the additional banks and individuals as defendants. At the same time, plaintiffs filed three virtually identical actions in Federal courts of three other jurisdictions against other banks. By Order of the Judicial Panel on Multidistrict Litigation, filed December 21, 1973, on motion by plaintiffs' counsel, the three actions were transferred to the Southern District of New York and assigned to Judge Bonsal to be consolidated with the instant action for pretrial purposes.

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* Erroneously denominated "Beatty" in the complaints herein.

The Amended Complaint

The Amended Complaint asserted a conspiracy among defendants Chemical Bank, its officers or employees Frank Beattie, John J. Irish and Paavo Prima; The Chase Manhattan Bank, N.A.; Marine Midland Bank - Western; Marine Midland Bank - Rochester; Lincoln First Bank of Rochester; Union Commerce Bank; and unidentified officers or employees of these banks, their names unknown to plaintiffs, to perfect a "preferred position as lienors upon the assets of Stirling Homex" Corporation (Stirling Homex) (¶ 30*--Appx 19a) accomplished by fraudulent misrepresentations that the banks would forbear from calling loans to Stirling Homex then outstanding, and would advance additional sums to Stirling Homex.

The plaintiffs, David Stirling, Jr., and William G. Stirling, holders of over 40% of Stirling Homex's common stock (¶ 5(c)--Appx 10a) and former officers and directors thereof (¶ 6--Appx 11a-12a), asserted in the first count that defendants' alleged conduct constituted common law fraud. This count was dismissed by Judge Bonsal for lack of jurisdiction and plaintiffs do not challenge that dismissal on this appeal.**

The second count asserted violations

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* All paragraph references are to the Amended Complaint, followed by a reference to the Appendix on appeal.

** In the case of eight of the nine defendants herein, Judge Bonsal's determination that there was no jurisdiction over the common law claims made it unnecessary for him to reach defendant's assertion that the representative claims could not be asserted by plaintiffs, but only by Stirling Homex. In the case of the ninth defendant, Union Commerce Bank, Judge Bonsal reached the question and so held. Plaintiffs were permitted to bring a new action against Union Commerce based on diversity of citizenship jurisdiction solely in connection with the charge that they had wrongfully been caused to resign their positions as officers and directors of Stirling Homex, 382 F. Supp. 1146, 1153.

of Section 10(b) of the Exchange Act (15 U.S.C. § 78j(b)) and Section 17(a) of the Securities Act (15 U.S.C. § 77q(a)). A third count asserted violations of Sections 13 and 16 of the Exchange Act (15 U.S.C. §§ 78m and 78p).

All counts purported to be class actions on behalf of "all persons who owned, purchased or sold securities of Stirling Homex between March 11th, 1972, and July 10th, 1972 . . ." (¶ 5(b)--Appx 10a).*

A. The Second Count

It is averred that Stirling Homex, a manufacturer and installer of modular housing, by July 29, 1971, had borrowed on an unsecured basis from various banks, including the defendants, upwards of $32,000,000 and that the defendant banks had, by January 24, 1972, the date of the Revolving Credit Agreement, advanced or caused to be advanced additional sums, so that all the outstanding advances aggregated approximately $38,000,000 (¶¶ 8, 9--Appx 12a).

In mid 1971, Stirling Homex entered into negotiations with the banks to effect a "line of borrowing" by Stirling Homex and its wholly-owned subsidiary, U.S. Shelter Corporation, of up to $55,000,000 (¶ 10--Appx 12a). Although Stirling Homex entered into the negotiations in good faith (¶ 11--Appx 12a), the defendants had no intention of meeting Stirling Homex's "working capital and cash flow" requirements, "but to the con-

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* At the same time the actions brought by plaintiffs were transferred to Judge Bonsal, a group of class actions brought on behalf of purchasers and sellers of Stirling Homex stock naming as defendants the plaintiffs in this action, the accountants and underwriters, among others, was also transferred to Judge Bonsal (with a separate docket number) also for pre-trial purposes. Those cases are proceeding to trial.

trary sought . . . to elevate themselves from the position of unsecured creditors to that of secured creditors . . ." (¶ 12--Appx 13a).

Plaintiffs further claimed that the defendants committed, beginning on or about the end of March 1972, the following fraudulent acts:

(1) filing, or causing to be filed, liens before a Revolving Credit Agreement between the banks and Stirling Homex became effective, thus purportedly making themselves secured creditors (¶¶ 38, 45--Appx 21a-22a, 24a);

(2) giving permission on April 15, for the payment by Stirling Homex of a dividend to its preferred stockholders as required under the Revolving Credit Agreement.

(3) contriving to compel plaintiffs to pledge all their unencumbered stock in Stirling Homex as further security for the outstanding debt and the further advances to be made under the Revolving Credit Agreement (¶¶ 40, 45--Appx 22a-24a);

(4) causing the election of a person approved and designated by defendants, as President of Stirling Homex (¶¶ 42, 45--Appx 23a-24a); and

(5) causing the resignations of plaintiffs as Chairman and Vice Chairman and members of Stirling

Homex's Board of Directors, and the resignation of Harold M. Yanowitch as Director, Executive Vice President, and General Counsel (¶¶ 43, 45--Appx 23a-24a).

It is further averred that defendants made false reports that they would refrain from calling their loans and would advance additional funds, and failed to make known their intention to do just the opposite, thus artificially inflating and maintaining the market price of Stirling Homex securities between March 11 and July 10, 1972. Plaintiffs, relying on the false reports, thereby supposedly sustained substantial damages (¶¶ 46, 47--Appx 24a-25a). It is not alleged, however, that plaintiffs either purchased or sold Stirling Homex securities during this period but only that the class which plaintiffs would seek to represent, purchased, sold or retained their securities (¶ 47--Appx 25a).

Plaintiffs demand damages and costs and expenses of litigation, including attorneys fees and accounting expenses.

B. The Third Count.

It is asserted that defendants, in addition to conspiratorial frauds and misrepresentations asserted in the second count, failed to file reports purportedly required of them as "insiders" and "control persons" under Sections 13 and 16 of the Exchange Act

(15 U.S.C. §§ 78m and 78p) (¶ 48--Appx 25a-26a). Plaintiffs seek unspecified damages and costs and expenses of litigation, including attorneys fees and accounting expenses.

Defendants' Motion to Dismiss

Defendants moved to dismiss plaintiffs' amended complaint, challenging the second count on the ground that plaintiffs did not allege that they purchased or sold securities in connection with the frauds averred. The third count asserting "control persons" liability under Sections 13 and 16 of the Exchange Act, was challenged on the ground that it failed to allege facts establishing "control person" status or violation of the statute. The first count was challenged for lack of pendent jurisdiction and for failure to state representative, as opposed to derivative, claims.

The District Court Opinion

Judge Bonsal held as to the second count that plaintiffs' failure to allege that they had either purchased or sold securities was a fatal defect. He found that plaintiffs' offer to pledge their stock was not a sale of security, since no pledge was ever made. The "Revolving Credit Agreement" was, on the face of the amended complaint, nothing more than "an ordinary commercial loan transaction" between Stirling Homex and defendants, which could not confer

upon shareholders in Homex the status of a purchaser or seller, 382 F. Supp. 1146, 1151.

Judge Bonsal dismissed the third count on the ground that "[p]laintiffs' complaint fails to allege that the defendants either acquired or were the beneficial owners of any Homex stock" 382 F. Supp. 1146, 1151. Moreover, Judge Bonsal held that plaintiffs had not alleged injury to themselves from the defendants' failure to file reports allegedly required by Section 13(d) or 16(a). He also rejected plaintiffs' theory of "deputization", asserted in their brief, but not in the amended complaint, with respect to plaintiffs' Section 16(a) claim.

Finally, having dismissed the Federal claims, Judge Bonsal dismissed the pendant state law claims as well.

Argument

POINT I

PLAINTIFFS WERE NEITHER PURCHASERS NOR SELLERS OF SECURITIES AND CONSEQUENTLY HAVE NO CLAIM BASED ON THE ANTI-FRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS.

A. Plaintiffs must be purchasers or sellers of securities in order to maintain a claim based on Section 10(b) of the Exchange Act.

The district court held that plaintiffs failed to aver that they purchased or sold securities in reliance on the alleged fraud, and that an action based on Section 10(b) of the Exchange Act (15 U.S.C. § 78j(b)) and Rule 10b-5 (17 C.F.R. § 240.10b-5) is available only to a purchaser of seller of securities. 382 F. Supp. 1146, 1150-51. Plaintiffs ask this Court either to repudiate the purchaser-seller requirement, or create an exception to that requirement which will allow them to maintain this action.

Plaintiffs assert in their brief that the purchaser-seller requirement "is no longer existent" (Br. 11), but decline to "burden this Court with plaintiffs' analysis" (Br. 13) in support of their assertion. The rule, however, is to the contrary.

> "It has long been the rule in this circuit that to maintain an action under § 10(b) of the Act and Rule 10b-5 of the Securities and Exchange Commission the plaintiff must have been a seller of the stock involved." Greenstein v. Paul, 400 F.2d 580, 581 (2d Cir. 1968).

More recently, this Court reaffirmed the requirement in the most unequivocal terms:

> " . . . Section 10(b) and Rule 10b-5 afford protection only to those who actually purchase or sell securities to their loss in reliance upon the withholding or misrepresentation of material information or other manipulative or deceptive devices." Haberman v. Murchison, 468 F.2d 1305, 1311 (2d Cir. 1972).

Plaintiffs' repeated reliance on Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) is misplaced. As this Court stated in Haberman,

> "Nothing in the Supreme Court's opinion in Supt. of Insurance of New York v. Bankers Life and Cas. Co., 404 U.S. 6 (1971) is to the contrary . . . [The Court] in no way suggested a rejection of the rule that a plaintiff under Section 10(b) must be a party to the sales transaction. The Court made clear that
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> > 'Manhattan [the injured party] was the seller of Treasury bonds and, it seems to us, clearly protected by § 10(b). . . . The Act protects corporations as well as individuals who are sellers of a security.' 404 U.S. at 9, 10 (Emphasis supplied)" 468 F.2d 1305, 1311 n.5.

The courts of this circuit have consistently applied the requirement. E.g., International Control Corp. v. Vesco, 490 F.2d 1334 (2d Cir.) cert. denied 417 U.S. 932 (1974); Molasky v. Garfinkle, 380 F. Supp. 549 (S.D.N.Y. 1974) (per Weinfeld, J.); In re R. Hoe & Co., Inc.,[1973-1974 Transfer Binder] Fed. Sec. L. Rep. ¶ 94,552 (S.D.N.Y. 1974) (per Tyler, J.).

Plaintiffs' assertion (Br. 28) that the rationale of the "injunction cases" (such as Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967)) lends support to the concept of granting standing to those who neither purchased nor sold securities is unsupported in those opinions. Mutual Shares was specifically predicated on the assumption

that injunctive actions were different from damage actions and consequently did not require the same limitations on standing:

> " . . . the claim for damages on this theory founders both on proof of loss and the causal connection with the alleged violation of the Rule; on the other hand, the claim for injunctive relief largely avoids these issues . . . ." 384 F.2d at 547.

Thus, even if it were alleged by plaintiffs (which it is not) that they intended to sell their stock in Stirling Homex but decided to hold it instead, in reliance on the asserted misstatements made by the banks, the purchaser-seller requirement of Section 10(b) would not be met. In re R. Hoe & Co., Inc., [1973-1974 Transfer Binder] Fed. Sec. L. Rep. ¶ 94,552, at p. 95,923 (S.D.N.Y. 1974); Levin v. Seilon, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. ¶ 92,941 at p. 90,487-88 (S.D.N.Y. 1970) aff'd, 439 F.2d 328 (2d Cir. 1971). See Greenstein v. Paul, 400 F.2d 580 (2d Cir. 1968).

Plaintiffs' reliance on Section 17(a) of the Securities Act (15 U.S.C. § 77q(a)) is similarly without substance. By its terms Section 17(a) applies to fraud committed by "person(s) in the offer or sale of any securities . . ." and, if the section be available to a private party, is available only to those who have purchased securities as a result of the fraud. Superintendent of Insurance v. Bankers Life & Cas. Co., 430 F.2d 355, 359 (2d Cir. 1970), rev'd on other grounds, 404 U.S. 6 (1971); Davidge v. White,

377 F. Supp. 1084, 1087-88 (S.D.N.Y. 1974); Berne Street Enterprises v. American Export Isbrandtsen Co., [1969-1970 Transfer Binder] Fed. Sec. L. Rep. ¶ 92,711 (S.D.N.Y. 1970).

B. Plaintiffs were not purchasers or sellers of securities.

The amended complaint fails to allege that either of the Stirlings purchased or sold securities. In an attempt to cure this fatal omission, plaintiffs, in their memorandum, suggest two ways this court may find such purchase or sale: (1) the Revolving Credit Agreement and the notes issued thereunder by Stirling Homex satisfy the requirement that the plaintiffs be purchasers or sellers of securities; or (2) the April 15, 1972, letter in which plaintiffs agreed to pledge their unencumbered Stirling Homex stock constitutes the sale of a security. As the district court held, neither of these assertions is sufficient to satisfy the requirement that plaintiffs be purchasers or sellers of securities.

1. Neither the Revolving Credit Agreement nor the notes issued thereunder grant purchaser or seller status to plaintiffs.

The short answer to plaintiffs' assertion that they are purchasers or sellers of securities by reason of the Revolving Credit Agreement and the notes issued thereunder is that the notes were issued to the banks by Stirling Homex and not by the plaintiffs. The Revolving Credit Agreement is an agreement between Stirling Homex and the

banks. Plaintiffs did not issue, buy or sell any of the notes under the Revolving Credit Agreement and it is not alleged that they did. Consequently, the Revolving Credit Agreement and the notes issued thereunder are irrelevant as far as plaintiffs' status is concerned.*

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* Furthermore, even if the banks had issued these notes to plaintiffs, there is serious question whether the notes issued under the Revolving Credit Agreement are securities with the meaning of the Exchange Act. Section 3(a)(10) of the Exchange Act (15 U.S.C. § 78c(a)(10)) specifically excludes from the definition of "security", "currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months . . . ." Plaintiffs concede that the notes in question had a maturity of less than nine months (Br. p. 25).

Notes of even longer duration have also been held to be outside the Exchange Act's definition of a "security" when issued as part of an ordinary commercial loan, Zeller v. Bogue Electric Mfg. Corp., 476 F.2d 795, 800 (2d Cir.) cert. denied, 414 U.S. 854 (1973); McClure v. First National Bank, 497 F.2d 490, 494-95 (5th Cir. 1974); cert. denied, 43 U.S.L.W. 3452 (U.S. Feb. 18, 1975); Zabriskie v. Lewis, [current] CCH Fed. Sec. L. Rep. ¶ 94,902 (10th Cir. 1974); C.N.S. Enterprises, Inc. v. G & G Enterprises, Inc., [current] CCH Fed. Sec. L. Rep. ¶ 94,938 (7th Cir. 1975); Lino v. City Investing Co., 487 F.2d 689, 694-95 (3d Cir. 1973). Cases cited by the plaintiffs (Br. 25) hold only that an investment security transaction, as opposed to a commercial loan transaction, is within the purview of the Exchange Act.

Similarly, the Revolving Credit Agreement, even if between the banks and plaintiffs, rather than the banks and the corporation, would be no more a security than the notes themselves. Plaintiffs' authorities are inapposite. United States v. Austin, 462 F.2d 724, 736 (10th Cir.), cert. denied, 409 U.S. 1048 (1972), involved a letter of commitment which was part of a fraudulent investment scheme and was "sold for a substantial consideration". Lehigh Valley Trust Co. v. Central National Bank, 409 F.2d 989 (5th Cir. 1969), involved not a borrower-lender situation but fraud in connection with the sale of a loan participation by one bank to another, and is thus irrelevant as to whether the Revolving Credit Agreement is a security.

2. The April 15, 1972, letter does not constitute a sale of Stirling Homex stock.

Plaintiffs assert in their brief (but not in the amended complaint) that the April 15, 1972, letter, in which they expressed their willingness to pledge their unencumbered Stirling Homex stock, constitutes a "sale" of this stock. It is not alleged that plaintiffs ever delivered or pledged their stock. Since "it is . . . essential to the existence of a pledge that there be a transfer of possession by a debtor" (53 N.Y. Jur. Secured Transactions § 39; New York U.C.C. 9-304), the April 15, 1972, letter does not itself constitute a pledge.

In any event, the only case considering whether a pledge of stock to a bank satisfies the purchaser-seller requirement of Section 10(b) has held that an unliquidated pledge does not. In McClure v. First National Bank, 497 F.2d 490 (5th Cir. 1974), cert. denied, 43 U.S.L.W. 3452 (U.S. Feb. 18, 1975), the court explained:

> "A commercial bank in accepting a pledge of stock as additional consideration for the extension of an overdue commercial loan does not necessarily affect the securities industry. A commercial bank's business is lending money not trading in securities. If the bank sells stock pledged as loan collateral, it might then be subjected to liability in connection with the sale if it does not meet the requirements of the anti-fraud provisions of the securities acts, but mere acceptance of a stock pledge as collateral

> in a privately negotiated transaction between borrower and lender does not, of itself, bring within the scope of the federal securities acts a transaction otherwise outside their purview.
>
> " . . . in this case the Bank did not foreclose on Mrs. McClure's pledged stock and did not sell it. Title to it remains in Mrs. McClure. Under these circumstances, her pledge did not constitute a "sale" of her stock within the meaning of section 10(b) of the 1934 Act and of Rule 10b-5." 497 F.2d at 495-96 (Citations omitted).

As Professor Loss commented in his discussion of whether a pledge constitutes a "sale" under the Securities Act of 1933 (15 U.S.C. § 77 et seq.): "federal legislation was hardly needed for privately negotiated pledge transactions between borrowers and lenders". 1 L. Loss Securities Regulation 649 (1961).

POINT II

PLAINTIFFS HAVE NO CLAIM BASED UPON SECTIONS 13(d) OR 16(a) OF THE EXCHANGE ACT.

The amended complaint is devoid of any allegations that any of the bank defendants (or any of their officers) at any time was, in the words of §§ 13(d) and 16(a), "the beneficial owner" of any Stirling Homex stock or that any of the defendants (or any of their officers) was, in the words of § 16(a), a "director or officer" of Stirling Homex. Consequently, none of the reporting requirements of Sections 13(d) or 16(a) of the Exchange Act apply.

In an attempt to remedy this defect, plaintiffs now assert in their brief that the April 15, 1972, letter, in which they expressed their agreement to pledge their unencumbered stock in Stirling Homex, constituted a sale of beneficial ownership to the banks.

As has been pointed out above, no actual pledge is alleged. In any event, a pledge of securities does not constitute an acquisition of a beneficial interest within the

meaning of either statute.*

Judge Kaufman held in GAF Corp. v. Milstein, 453 F.2d 709, 716 (2d Cir. 1971), cert. denied, 406 U.S. 910 (1972) in construing Section 13(d):

> "We find ourselves in agreement with the statement of the Court of Appeals for the Seventh Circuit in Bath Industries, Inc. v. Blot, 427 F.2d 97, 112 (7th Cir. 1970), that in the context of the Williams Act . . . 'voting control of stock is the only relevant element of beneficial ownership.'"

See, Graphic Sciences, Inc. v. International Mogul Mines Ltd., [Current] CCH Fed. Sec. L. Rep. ¶ 94,834 (D.D.C. 1978) at p. 96,802 n. 35. Plaintiffs do not allege that the banks ever acquired voting rights of Stirling Homex stock by reason of the April 15, 1972, letter.

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* Plaintiffs contention (Br. pp. 35-36) that this agreement contemplated more than "a mere naked pledge" because the existence of acknowledged prior defaults by Stirling Homex meant that "mere formality would convert their title from that of a pledgee to an absolute owner" is refuted by the terms of the letter itself which merely provided that "such pledge [would] be terminated when all defaults by the company have been cured" (April 15, 1972, letter ¶ 5) and did not contemplate an immediate liquidation at the banks' "whim and caprice" (Br. 36). The terms of the pledge, moreover, were never negotiated and thus any assumptions about what rights the parties might have had is pure conjecture. Plaintiffs' apparent argument that they were giving the banks title to securities alleged to be worth up to $70 million in exchange for a temporary forebearance on the outstanding loans is simply not credible.

The precedents construing "beneficial ownership" under Section 13(d) should be equally applicable to the identical language of Section 16(a). In any event, the status of a pledge under Section 16(a) is set forth in Rule 16a-6 (C.F.R. § 240.16a-6):

> "2. The right of pledgee or borrower of securities to sell the pledged or borrowed securities is not an option or right to sell securities within the meaning of this section. However, the sale of the pledged or borrowed securities by the pledgee or borrower shall be reported by the pledgor or lender."

A pledge, consequently, is not an event which must be reported and the duty to report any liquidation of the pledge falls upon the pledgor.

Plaintiffs, conscious of the failure of the amended complaint to allege that any defendant was an officer or director of Homex, allege in their brief (pp. 43-44) that the banks had a "deputy" in the management of Stirling Homex and thus were subject to the reporting requirements of Section 16(a). The concept of deputization, however, is irrelevant to Section 16(a) and plaintiffs cite no cases which extend that concept (which has been applied to Section 16(b)) to the reporting provisions of Section 16(a).

Indeed, in Feder v. Martin Marietta Corp., 406 F.2d 260 (2d Cir. 1969), cert. denied, 396 U.S. 1036 (1970),

relied upon by plaintiffs, the court stated that there was no remedy against the use of inside information other than the recovery of short-swing profits:

> "The only remedy which the framers of § 16(b) deemed effective to curb insider abuse of advance information was the imposition of a liability based upon an objective measure of proof . . . . Section 16(b) liability is automatic, and liability attaches to any profit by an insider on any short-swing transaction . . . ." 406 F.2d at 262.

In Blau v. Lehman, 368 U.S. 403 (1962), also relied upon by plaintiffs, the Supreme Court declined to impose liability on Lehman Brothers, who had earned short-swing profits by trading in the stock of a company which had a Lehman Brothers partner on its board, in the absence of a finding that Lehman Brothers had traded on inside information.

There is no allegation that defendants earned any short-swing profits and consequently no liability may be imposed upon the defendants under the cases cited by plaintiffs.

Under Section 13(d), even if a private right of action for damages exists, it is not available to plaintiffs who had not relied to their detriment on the failure to report. Washburn v. Madison Square Garden Corp., 340 F. Supp. 504 (S.D.N.Y. 1972); See Grow Chemical Corp. v. Uran, 316 F. Supp. 891 (S.D.N.Y. 1970). The cases relied upon by plaintiffs (Br. 39)

are either injunction cases or involve detrimental reliance on the part of the plaintiff.

The plaintiffs were parties to the very transaction they claim should have been reported. They cannot possibly assert that they would have acted differently had the transactions been reported. Indeed, on its face, if the plaintiffs were correct that the transactions should have been reported, they, as officers, directors, and as holders of over 10 percent of the shares of Stirling Homex stock had the duty to report the transactions. Rules 13-d(6); 16-a(1)(d),(e).

As far as Section 16(a) is concerned, no private right of action for damage exists. Smith v. Murchison, 310 F. Supp. 1079 (S.D.N.Y. 1970); Robbins v. Banner Industries, Inc., 285 F. Supp. 758 (S.D.N.Y. 1966); 2 L. Loss, Securities Regulation, 1040, (1961).*

Section 16 was designed to prevent trading on inside information, which is not alleged here, and Section 16(b) provides the remedy by authorizing an action by the corporation, or on its behalf, to recover any short-swing profits.

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* Grow Chemical Corp. v. Uran, 316 F. Supp. 891 (S.D.N.Y. 1970), relied upon by plaintiffs, involved asserted violations of both Sections 13(d) and 16(a). The Court's holding, without specifying upon which section it relied, that a cause of action had been stated under the federal securities laws, if good law, should be read as upholding a claim under 13(d), as the court made no attempt to distinguish the unanimous contrary authority construing § 16(a).

Conclusion

For all the foregoing reasons, the judgment below should be affirmed. We believe Judge Bonsal's decision to be so clear and correct and plaintiffs' appeal so devoid of merit that the Court should award to appellees double costs and in addition damages in the form of a reasonable counsel fee. 28 U.S.C. § 1912; F.R.A.P. 38. See, Simon & Flynn,Inc., v. Time Incorporated, Civil No. 74-1976 (2d Cir., Apr. 2, 1975). In this connection we call to the Court's attention facts revealed in the records of this Court in connection with defendants' motion to dismiss plaintiffs' appeal.

April 21, 1975

Respectfully submitted,

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